

WHO BENEFITS FROM ACT 10 MORTGAGE INTEREST
SUBSIDY PROGRAM ? A CASE STUDY OF LAS ANTILLAS
HOUSING PROJECT, SALINAS, PUERTO RICO

by

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ABSTRACT

Since its inception in 1973 the Act 10 mortgage interest subsidy program has provided approximately 23,544 moderate income families an opportunity to become homeowners. The program was a response of the Commonwealth of Puerto Rico to the land invasions movement that emerged on the Island in 1968, and peaked in 1972. The program was also a response to the moratorium imposed by President Richard M. Nixon on the Section 235 Homeownership Program in January 1973.

For approximately 5,886 owners of government financed housing units, Act 10 became an obstacle for continued ownership. Alternative explanations as to why government financed housing projects are experiencing default rates as high as 50 %, (while privately financed housing projects are experiencing a default rate of 9 %), have been proposed by the Department of Housing (DOH), the legislature, and the homeowners themselves. The explanation with which this thesis is concerned is that given by the DOH. The DOH contends that the origin of the problem is a consequence of the bad qualification process administered by the DOH itself, and the lack of homeowner interest in keeping their homes.

This thesis is a case study of one of 72 government financed housing projects and was undertaken to prove that the combination of the fixed nature of the subsidy mechanism, the impact of employment instability among these families, and the lack of effective responses from the DOH to default episodes are stronger explanations to such a high default rate. The thrust of the findings tended to confirm this contention.

A more complete assessment of the impact of the program in all government and privately financed housing projects is needed. A broader analysis of the experience gained through this program is urgently needed in order to correct the problems inherent to it.

Future housing policies and programs should be formulated and implemented as part of a coherent economic development

strategy for Puerto Rico. No homeownership program will effectively address the housing needs of those in the lower end of moderate income families unless employment issues are fully addressed by the Government and the private sector.

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Chapter 1: Introduction

On July 5, 1973, the Governor of the Commonwealth of Puerto Rico signed a Bill creating for the first time in P.R. a government assisted market mortgage interest subsidy program. This came six months after President Richard M. Nixon imposed a moratorium on Section 235 Homeownership Program. A program for moderate income families, Act 10 of July 5, 1973, was created by the administration of Governor Rafael Hernandez Colon as both a response to the negative impact of the moratorium on Commonwealth housing programs and the housing construction industry, and to the acute shortage of housing as reflected in the land invasions movement 1_/ that emerged on the Island in 1968, peaked in 1972, and disappeared temporarily in 1976. 2_/

In June 1979, I was working as an organizer for a community development corporation based in the southeast region of the island. I met with residents of a government promoted Act 10 housing project in the municipio of Salinas to discuss their problems and see how the CDC could be of help to them. Las Antillas housing project in Salinas is one of 72 housing projects that as of August, 1981, was promoted by three agencies of the Department of Housing of the Commonwealth of P.R. --the Urban Renewal and Housing Corporation (URHC- 58

1_/ Land invasions are defined here as a type of illegal occupation of public or private land, i.e. squatting. Its specificity is that it is a consciously-planned collective process organized by homeless families, usually with some external support.

2_/ On November 1980 a new wave of land invasions erupted in the north-east region of P.R.

projects), The Rural Housing Administration (RHA- 6 projects), and the Housing Bank and Finance Agency (HBFA- 8 projects).

In that meeting, two fundamental problems were discussed. The first one was the problem of plant closings in the region. Because of the plant closings, a number of residents became unemployed and, therefore, were unable to meet their monthly mortgage payments. This situation was complicated by the fact that Act 10 mortgage interest subsidy was reduced automatically every two years without taking changes in the economic capacity of homeowners into consideration. Although some of those affected by plant closings were able to find jobs, they were receiving smaller salaries compared to their previous positions. They were still ,however, required to pay higher monthly mortgage payments every two years.

The second problem presented in that meeting was concerning construction defects such as filtrations through ceilings and walls, and cracks in walls and floors, among others. These construction defects were present in almost all housing units of the project and to this day have not been remedied.

The residents of Las Antillas have been forced to fight on two different fronts; the legal front, pursuing an indemnification for the construction defects, and the political front, pursuing an amendment or derogation of Act 10 to make it more responsive to their changing socio-economic situations, giving them better opportunities to keep their homes.

The residents of Las Antillas began their struggle in 1978. They requested from the Department of Housing (DOH) an assessment

of the value of their homes given the construction defects. They further asked for an adjustment of the value of their homes and, therefore, their mortgages, given the depreciation of their homes. This request encountered a strong opposition from the DOH--they still continue to oppose this solution. The DOH's main argument against this strategy has been that a commitment was made with the bond investors and no change can be made on this commitment. It is the DOH's contention that the mortgages have to be paid regardless of the construction defects.

However, in the courts both issues have been linked, but in a way that has been detrimental to the resident's interests as consumers. In order to be in a strong position in the court in their demand for construction defects against the DOH and the contractor that built their community it is important that the residents of Las Antillas be timely with their mortgage payments. This requirement of being timely with mortgage payments in order for the residents to show that they are dealing in "good faith" forced them to put all their energies in the political front pursuing the amendment or derogation of Act 10. To keep up with mortgage payments was an impossible task for a majority of the residents.

The lawyer of the residents of Las Antillas developed and submitted a bill to the Senate's Commission on Housing and Urban Development to derogate Act 10 and substitute it with a similar subsidy program created by the Commonwealth on June 14, 1980--Act 141. Act 141 is a mortgage interest subsidy program for

the term of mortgage for moderate income families, which is to be readjusted every two years or whenever a change in family income occurs. This bill would have allowed Act 10 homeowners and those who were in the process of becoming homeowners under the program, to voluntarily apply for the benefits provided by Act 141. The goal of the bill was to provide consumers with a better chance to keep their homes under changing economic environments.

The bill that the Commission finally presented to the Senate in January 1982 did not derogate Act 10 but amend it, using Act 141 as the model. Senate Bill 417 of January 18, 1982, incorporated a mechanism of voluntary and mandatory recertifications of family income in order to adjust the subsidy to what the family was able to allocate. This amendment would have also permitted the reduction of the subsidy in those cases where the family income allowed it.

This bill had been consecutively approved by the Senate and the House since 1982, and had always been vetoed by former Governor Romero Barcelo. As of January 1985, the balance of the struggles of the residents of Las Antillas had been negative: they had not succeeded on either the legal or the political front.

Las Antillas is not the only government promoted Act 10 housing project where homeowners are confronting problems in various degrees. But, efforts made by a number of Act 10 communities to create and consolidate into a national committee have not succeeded. Las Antillas has been struggling alone since 1978.

Former Secretary of Housing, Jorge A. Pierluisi, the residents of Las Antillas and their lawyer, and the Senate's Commission on Housing and Urban Development have all proposed alternative explanations as to why these homeowners have been confronting problems paying their mortgages.

Jorge A. Pierluisi has argued that the origin of the problems of these homeowners can be encountered not in the subsidy mechanism, but in the qualification process of the families administered by the DOH. 3_/ He has stated his belief that many of the residents are simply not interested in keeping their homes. Secretary Pierluisi elaborated this position in a letter sent to the President of the Senate's Commission on Housing and Urban Development.

"...[A]lmost all the repossessed housing units were owned by families that, even though we would have liked to adjust their monthly payments, they did not have the capacity to continue paying their homes, or simply have lost their interest in keeping them." 4_/

No information has been provided by the DOH to sustain this statement.

The residents of Las Antillas and their lawyer have argued that the origin of their difficulties can be found in Act 10 itself, specifically in its duality of goals. Act 10 was supposed to help moderate income families acquire homes, as well as to inject \$247 million into the housing construction industry which was unable to continue with its projects due to

3_/ DOH comments on Senate Bill No. 417, February 10, 1982, p.1

4_/ Letter from the Secretary of Housing to Senator Jesus Santa Aponte, September 23, 1981, p.3.

Nixon's moratorium. The residents argue that this duality caused the creators of Act 10 to leave out elements (such as employment stability) in their analysis of the Island's economic structure which directly affect the capacity of moderate income families to acquire housing in the open market. For instance, the subsidy is automatically reduced every two years, until year 14 of the mortgage. This feature of Act 10 shows that its creators assumed that the Island's economy would experience a steady growth throughout the 1970's, and that family income would steadily rise. The residents of Las Antillas assert that this assumption reflects the lack of attention paid to the consumer side of the program by its creators. Income has not risen steadily, and many families have lost or are losing their homes.

The analysis of the Senate's Commission on Housing and Urban Development basically follows the analysis of the residents of Las Antillas. The Commission understands that an amendment to Act 10 is necessary in order to make it more equitable, and to give the homeowners better opportunities to keep their homes. Unfortunately, the DOH did not submit complete information regarding their analysis at public hearings held in August, 1981, to discuss the problems of Act 10. Thus, in creating the bill, the Senate relied mostly on the information and analysis provided by the residents of Las Antillas and their lawyer, without the benefits of a more complete assesment of the problems confronted by government financed Act 10 housing projects by the DOH.

In the bill's introduction it is stated that those housing units that were sold and financed by the private sector, (whose

buyers were qualified by private financial institutions) have a default rate lower than nine percent (9%), while in the units that were financed by the government, the default rate exceeds fifty percent (50 %). This data moved the Commission of Housing and Urban Development to conclude the following:

"This data could indicate a bad initial qualification of the families that applied to the subsidy provided by Act 10, but at the same time does not exclude the existence of other factors that...could have contributed in generating the tardiness existent in the program...[T]here is no base to conclude that the delinquency rate indicates a generalized pattern of behavior that is based on the irresponsibility and lack of citizens conciousness". 5_/ (emphasis mine)

What explains the difference in the tardiness rate between the privately financed and government financed housing projects ? This is an important piece of information that has yet to be fully addressed by the DOH. At this moment, though, no research on this subject has been made either by the DOH or the Commission.

To date, there are approximately 23,544 families living in government or privately financed Act 10 subsidized housing units. All of those who applied for the program were first time homeowners. The program was their immediate alternative to solving their housing needs. For approximately 6,121 homeowners of government financed Act 10 housing units, though, the alternative evolved into a nightmare. This subsidy program has become a formidable obstacle for these homeowners trying to keep their homes.

It is my contention that there are alternative explanations as

5 / Senate Bill No.417, January 18, 1982, p.2.
to why the government financed housing units have such a high

default rate other than the quality of the qualification process implemented by the DOH and the irresponsibility and lack of consciousness of the homeowners. Other explanations that have not been mentioned by officials of the DOH that could explain such high default rates are as follows:

A) The combination of the fixed nature of the subsidy mechanism and the impact of employment instability on these families.

B) Lack of effective responses from the DOH and mechanisms to deal efficiently with the problems of defaults.

The purpose of this study is to evaluate the experience of those homeowners of government financed Act 10 housing projects by doing a case study of Las Antillas in order to prove my contention and to assess the effectiveness of this program in reaching its stated goals and target population, and the effectiveness of the DOH in monitoring this program. The central argument here is that Act 10 is not a public housing program created to benefit consumers, the construction industry, and the banks equally. Rather, it was created for the sole purpose of encouraging the production of housing given the reduction and elimination of Federal funds. The creators of Act 10 did not give enough consideration to the needs of low and moderate income families, thus creating obstacles for them in keeping their homes.

In Chapters II and III, I will discuss the history of Act 10 and its evolution since 1973. The history of Act 10 is important given the dependency of the housing delivery system

of P.R. on federal housing policies and programs and the impact of this dependency in shaping the objectives that guided the design of the Act 10 Mortgage Interest Subsidy program.

In Chapter IV, I will discuss the problems of Act 10 in the specific context of the Las Antillas housing project and the resident's demands.

In Chapter V, I will discuss government responses to the demands of Las Antillas residents regarding mortgage payments problems.

In Chapter VI, I will summarize the major findings of the research and develop specific recommendations regarding program evaluation and other studies in order to assess whether it is feasible or not to amend, derogate, or substitute Act 10 with other program that takes into consideration the best interests of all the parties involved.

Chapter II. Section 235: Reasons for its suspension and impact
of its suspension

Reasons for its suspension

At its emergence during the late 1960's, the concept of a federal policy of lower-income homeownership which would subsidize and underwrite the purchase of homes in the open market by families of relatively marginal income was hailed by its chief progenitor, U.S. Senator Charles Percy, as "a new dawn for our cities". 6_/ The concept was forged into legislation as the Section 235 program of the Federal Housing Act of 1968.

Section 235 provided payments by the Secretary of the Department of Housing and Urban Development (HUD) to mortgagees on behalf of the mortgagors. This is a supply-side subsidy program which encourages private money sources to extend their mortgage funds rather than to have the government do so. This program provided lending institutions with mortgage insurance, and reduced the homeowner's housing costs by making payments to the mortgagees on behalf of the owners. A family had to contribute a prescribed amount of income toward the debt service, and the government made up the difference between the market cost and the contribution.

The intention of Section 235 was to reach families with an income range from \$3,000 to \$7,000. Eligibility was restricted to families with incomes not more than 35% above maximum public

6_/ Senator Charles Percy, "A New Dawn for Our Cities", Congressional Record--Senate, October 17, 1966, pp. 27258-27260.

housing ceilings in each community, with deductions allowed for dependents.

Some serious concerns about Section 235 and its weaknesses were spelled out by various housing analysts since its inception. One concern was that Section 235 was designed primarily to increase the U.S. housing stock. The U.S. government program was part of an announced plan to build six million housing units for low and moderate income families through the 1970's. The goal of high volume of housing production was seen as a competitor to the goal of helping poor families succeed as homeowners. 7_/ (As will be discussed later, this duality of goals was also a characteristic of the Act 10 subsidy program).

Another concern was that the subsidy calculations spelled out in the housing act failed to include certain major housing expenses --particularly utilities and maintenance-- as part of the housing costs. Each family was required to pay 20% of its income for interest, amortization, insurance, and taxes. In many northern cities of the U.S. where heating bills are high, owners had to spend additional money each month for utilities and maintenance, and were therefore expected to spend more than one fourth of their income for housing. This budgetary strain would be further compounded for low-income families where the sales price of many homes is high. This was expected to make it very difficult for families at the low end of the \$3,000 -

7_/ Frieden, Bernard, et.al., "Home Ownership for the Poor", in Transaction, 1970, p.52.

\$7,000 range to afford the cost of modest new houses. 8_/

Also, instead of encouraging the use of old housing to accomodate low-income families, Section 235 emphasized the construction of new housing, and restricted the use of existing housing units.

Given the prevailing climate of urban discontent and turbulence during the 1960's in the U.S., the administration of President Johnson and the Congress deemed it preferable to act under uncertainty on how the program would perform rather than to delay action on the program. This program came to be considered by the Congress as a significant response to the housing and residential stresses endemic to lower income households in the cities across the U.S.A.

Two years after its implementation, the 235 program was badly shaken by the exposure of market abuses and federal maladministration which permeated a substantial sector of the national efforts in the U.S.. Many families were left the title-holders of sorely deficient and often overpriced housing units. Rising mortgage default rates throughout the program and the high rate of mortgage failures in some areas served to stigmatize the image of the program even further.

By 1970, these events in the U.S. made the program increasingly vulnerable to the will of an administration, headed by President Richard M. Nixon, which was uninterested in the cause of federal assistance to the nation's housing poor. Despite many attempts on the part of the Department of

8_/ Ibid.

Housing and Urban Development (HUD) to remedy defects in operation of the program and improve its ability to realize its potential, the administration imposed a moratorium on any further housing subsidy commitments in January, 1973. The program had been in existence for approximately four years before it was terminated. It was reactivated in 1975, with revisions.

In the early 1970's, the Federal Government forwarded interpretations of the problematic nature of the Section 235 program experience. Their interpretations described the shortcomings of the program as either being a failure in the policy concept itself or in the administrative implementation of otherwise realizable objectives. The first interpretation holds that there is an inherent incompatibility between the demands of homeownership and the conditions of life within the margins of lower-income. The "life at the margin" theory maintains that lower-income families are incapable of sustaining ownership obligations because of intermittent crises (eg. in employment, health, and family stability) which assume catastrophic proportions.

The second interpretation holds that flawed implementation was a primary contributor to the 235 program's malconsequences, leading to market abuses and the placing of many lower-income purchasers in untenable ownership situations characterized by seriously defective housing conditions and negative equity positions at purchase.

In contrast with these assertions about the program as a whole, strong local variations in program performance in the

U.S. were increasingly evident by the eve of the subsidy moratorium--mortgage default rates varied from a low 2% in one HUD area office to a high 20% in another. 9_/ However, little consideration was given to alternative factors contributing to local differences in program performance in the US, such as local economic conditions and the extent to which they were favorable or unfavorable to sustained homeownership. This "contextual" interpretation 10_/ was mentioned briefly in the Congress' attempt to diagnose the problems that were manifest in the program. Such a "contextual" interpretation would have seemed likely in the face of the strong local variations in program performance that were evident by the eve of the moratorium.

Impact of the moratorium in P.R.

The first reactions to the moratorium in P.R. came from the Governor of the Commonwealth and from builders.

The newly elected governor, Rafael Hernandez Colon announced on January 10, 1973, that he would study the "adverse effects" of the Nixon moratorium. Representatives of the construction industry stated that the action taken by the Federal government would bring great difficulties to the industry. 11_/ Meanwhile,

9_/ U.S. Congress Housing Subsidies and Housing Policies, Hearing Joint Economic Committee, 92nd congress, Second Session, December, 1972, p.37.

10_/ Bach, Victor, Chance to Own, Phd Dissertation, MIT, DUSP, 1977, pp. 13,14.

11_/ El Mundo, January 10, 1973, San Juan, P.R., p.1

the newly appointed Secretary of the DOH, Jose E. Arraras, stated that he lamented Nixon's intention to revise and possibly withhold any further financial help for housing which in P.R. had been (and still continues to be) of great importance for the construction of public housing. 12_/

In order to appraise the context in which these reactions were given, a brief review of the Island's history since 1898 will follow, including a discussion of the interventions by the government of P.R. in the housing sector.

Puerto Rico became a territory of the U.S. in 1898 by virtue of the peace agreement negotiated between Spain and the U.S. after the latter won the Hispanic-American War.

From 1898 to 1900, a U.S. military government administered the colony. From 1900 until 1944, all of the governors who succeeded the previous military government were North-Americans appointed by the president of the U.S. In 1944, the U.S. President appointed a Puerto Rican governor.

Since 1948, the governor has been elected by the people of P.R. It was not until 1952, however, with the creation of the constitution of the Commonwealth of Puerto Rico, that a more complete political and judicial autonomy was achieved. This constitution was sent to the U.S. Congress for consideration and approval.

The Constitution did not alter the character of the relationship between P.R. and the U.S. --P.R. still being considered a territory of the U.S. Specifically, the Law of

12_/ Ibid.

Federal Relations which regulates the relations between both countries, was not altered. Even today, the Congress still has the power to unilaterally amend the Law of Federal Relations, or even to unilaterally amend the Constitution of the Commonwealth.

The Puerto Rican state is subordinated to the U.S. and functions as a partially autonomous state. Therefore, its urban policies have to be seen as influenced by and/or dependent on U.S. urban policies.

In P.R., the idea of a program for housing development began formally with Act. 53 of 1921, creating the "Division de Hogares Seguros" as part of the Department of Labor. But the real implementation of a housing policy by the government of P.R. was initiated when the US Congress started legislation for funding the development of housing programs.

In 1938, Act 126 created the Puerto Rico Housing Authority enabling the Island to qualify "for the benefits offered by the Act 412 of the U.S. Congress of 1937, establishing the Federal government policy to utilize their funds and credit to help the States improve the unsanitary and unsafe living conditions of low income families. 13_/"

Act 126 of May, 1938, created several public corporations known as "Autoridad de Hogares" (Housing Authorities) whose principal purpose was to eliminate the slums and to provide housing to low income families. The Housing Authorities of San

13_/_ Department of Housing, Evolution of the Department Of Housing, Commonwealth of P.R., Hato Rey, January, 1982, p.1.

Juan, Ponce, Mayaguez, Arecibo, as well as the Puerto Rico Housing Authority --which coordinated all the local Housing Authorities-- were created under this act.

Public housing construction began in 1940. Shortly thereafter, when World War II began, the construction of new public housing was halted due to restrictions on federal aid for this purpose. During the war, the Puerto Rico Housing Authority began the aquisition of land in preparation for the federal government post-war program.

In 1954, the U.S. Congress approved the Public Housing Act, which changed drastically public housing and urban renewal in P.R. Before the existence of this Act, the Federal government gave help to the states and municipalities both for the construction of public housing and for urban renewal, but these activities were not carried out in a coordinated fashion. The construction of public housing was authorized without the commitment that it would house families displaced by slum clearance programs.

The Federal Housing Act of 1954 had the cooperation with urban communities in order to help them prevent and eliminate slums and decaying areas as its main philosophy. Most efforts were guided toward preventing the emergence of slums. The communities were responsible for slum eradication and local resources were used for this purpose.

In Puerto Rico, these programs were not as successful as expected. The housing problem became worse due to the growing migration movements of displaced and impoverished peasants from rural to urban areas during the 1940's and 50's. The local

housing authorities were unable to cope with the growth of slums in the urban zones, and housing conditions deteriorated.

In 1957, a new agency was created by the P.R. Legislature to cope more efficiently with the rapid population growth of the urban centers, the deterioration of some urban districts, and the formation of squatter settlements. The Urban Renewal and Housing Corporation (URHC) was created by Act No.8 of 1957, grouping the four housing authorities into a single public corporation. The purpose of this legislation was to create a central unit for achieving coordination among the different housing programs. The URHC had the following as its main objectives: the construction of public housing, low cost housing for families of moderate income, and urban renewal and slum clearance.

In June 1972, another important step in the centralization process was made with the creation of the Department of Housing. All housing programs previously carried out by various governmental agencies (such as the Department of Agriculture, URHC, the Housing Bank, and the Administration of Rural Housing) were transferred to the DOH.

Currently, the DOH carries out its activities with the help of the URHC, the Administration of Rural Housing, the P.R. Housing Bank and Finance Agency, the P.R. Housing Finance Corporation 14_/ and the Administration of Public Housing.

An analysis of the evolution of the housing policies and programs of the government of P.R. since 1921 (in particular, an

14_/ The Puerto Rico Housing Finance Corporation is a subsidiary of the Government Development Bank of Puerto Rico.

analysis of the relationship of P.R. housing policies with those operating at the federal level) is yet to be done. Still, it can be said that, in general, the government of P.R. has in the past depended upon and has followed federal policy concepts, using them as models in its intervention in the housing sector on the Island. As we will see later, the creation of Act 10 followed this scheme.

The extent to which the government of P.R. has relied on federal funds since 1938 for its housing programs was best expressed by the Secretary of Housing, Jose E. Arraras, on February 1973. Arraras recognized that "what has been achieved on public housing and housing subsidy programs was due to federal housing programs." 15_/ But the private housing construction industry has also depended on Federal programs. For example, the percentage of new private housing in P.R. subsidized under the provisions of Sections 235 and 236 went from a low 5.4 % in 1969 to 30.6 % in 1972. (Refer to Table 1, p. 20).

This dependency of the Commonwealth on Federal funds in order to develop its housing programs (as well as that of the private sector) was furthered by the worsening of the housing problem, i.e. the situation of housing scarcity among the urban poor in the late 60's. From 1968 to 1976, the government of P.R. was confronted by the emergence of an aggressive land invasions movement. Land invasions became a popular answer to

15_/ El Mundo, February 23, 1973, front page.

the housing crisis. 16_/ In January 1973, the Secretary of Housing declared that land and housing invasions amounted to 1,500.

TABLE 1: Construction of new private housing units with Section 235 and 236 subsidy: 1969 - 1973

Fiscal Year	Total Units	With Sections 235 & 236 Subsidy	% Subsidized
1969	17,495	938	5.4
1970	16,609	4,670	28.1
1971	16,826	6,022	35.8
1972	20,328	6,230	30.6
1973	20,562	3,853	18.7

Source: P.R. Planning Board.

Why this type of housing movement emerged on the Island is still to be researched thoroughly. The central argument of research currently in progress in P.R. 17_/ is that the land invasions movement emerged in that period because of a crisis in the economic development strategy implemented by the Government of P.R. since the 1940's coinciding with a new conjuncture of political and ideological events. Such events would include the following: the first electoral defeat of the Popular Democratic Party after 28 years of uninterrupted

16_/ While the land invasions movement, i.e. squatting (in its different forms) and its result, the squatter settlement, have been extensively studied in the social sciences literature on Latin America, little has been written about the subject in Puerto Rico.

17_/ Cotto , Liliana, "General Background Bibliography for the Dissertation: State Responses to Land Invasions in Puerto Rico; 1968-1979", p.3. (Undated).

control of the colonial state apparatus (1940-1968); the unsatisfied rising expectations generated by the electoral promises of the New Progressive Party (a pro-statehood party that from January 1969 to December 1972 administered the colonial state apparatus); the organizational support given to popular movements by the Puerto Rican Independentist Party and the Movement Pro Independence (both parties of socialist ideologies at that time), and the imprecision of the state apparatus policy towards invasions and housing for the poor in a situation of a changing economic scene.

Nixon's moratorium was announced in the context of that housing crisis and the growing dependence of the Island on Federal transferences. It was clear that the decision was adverse to the island. But what were the alternatives?

Social and economic data, analysis of the Island's housing problem, and specific recommendations were provided by the different interest groups of the housing sector from January to March 1973, and echoed by El Mundo, a national newspaper.

For example, one expert assessment of the impact of the moratorium said that "[it would] affect about 80% of Puerto Rico's population that qualify under the different programs that were affected by this decision " (Section 235, and Section 236, among others). 18_/ According to an editorial writer of El Mundo, the number of housing units financed annually with Federal funds was approximately 8,000. 19_/

18_/ El Mundo , January 10, 1973, p. 1-A

19_/ El Mundo , January 11, 1973, p. 6-A

And in his message to the Senate and House on January 31, 1973 on the condition of P.R., the governor acknowledged that...

"one third of both rural and urban houses are inadequate...
"[T]he invasion of land and housing that have recently become worse and extended, is an authentic proof of the existence of that "crisis"..There is not enough housing for young families." 20_/_

A consensus between the Government and interest groups on how to cope with the situation began to take shape during late January and early February.

An alternative to cope with the crisis was suggested in the editorial page of El Mundo on January 11, 1973, (a day after the Governor's reaction to the moratorium).

"We expect that from conventional sources adequate financing will be obtained so that housing construction programs could be developed as to cover the basic housing needs of those sectors interested in buying an intermediate cost housing unit." 21_/_

On January 13, the Secretary of the DOH stated that in order to counteract the moratorium effects, the government would have to look for significant resources at the local level and that ...

"it will be necessary to multiply the assigned local [public] funds." 22_/_

In his message to the legislature, Governor Rafael Hernández Colon insisted that with local initiative and with part of an issuance of bonds by the URHC for 150 million

20_/_ El Mundo , January, 31, 1973, p. 12-A

21_/_ El Mundo, January 11, 1973, p. 6-A.

22_/_ Ibid.

dollars it would be possible to double the construction of new housing on the Island. 23_/ He also mentioned that his administration would see to it that the private banks channel "their funds to finance housing for families of meager resources and, in that way, assume a role of ample social content". 24_/ In that same speech, he asserted that there were a number of institutions that had already expressed their interest in collaborating.

At last, on February 4, 1973, the Secretary of the DOH provided more specific information on the plan. He announced that "in the near future a Housing Financing Plan will be established" that would put millions of dollars to the disposition of families with monthly incomes that ranged between \$250 and \$700. In P.R. at that time, that income was representative of low to middle income families.

During the weeks that followed, more specific information on the plan was provided, and compromises at some levels were reached.

On February 8, the directors of commercial private banks met with the Secretary of Housing to discuss the housing problems of P.R. and to explore new alternatives for financing housing through banking institutions. Among the alternatives that Arraras discussed with bankers was to convert the Housing Bank to an agency similar to the FHA, (Federal Housing Administration). It was hoped that this new agency could

23_/ El Mundo, January 31, 1973, p. 6-A.

24_/ Ibid.

provide an insurance or mortgage guarantee of low cost housing which would stimulate the mortgage market for these housing units. 25_/

The Governor accepted a proposal from the First Federal Savings and Loan Association of \$25 million for the financing of low cost housing promoted by the DOH, with mortgage guarantees provided by the Housing Bank. 26_/ Even though all of the specifics of the housing program (they referred to it only as a "plan") were not yet known, it was stated that mortgages were to be guaranteed mostly to persons with monthly incomes that ranged between \$240 and \$750 (\$2,880 and \$9,000 yearly) an income range similar to that established in Section 235.

On March 5, the nine institutions that comprised Puerto Rico's Saving and Loan Association League stated their intention to cooperate with the plan proposed by the Secretary of Housing to generate local resources for the construction of housing for families of meager economic resources. 27_/

Specifics of the entire program were not made public until July 6, a day after the bill creating Act 10 mortgage interest subsidy program was signed by the Governor.

The analysis of the information that appeared in El Mundo, the most important newspaper on the Island and the more influential, tends to indicate that the initial plans to create

25_/ El Mundo, February 9, 1973, p. 3-A.

26_/ El Mundo, February 24, 1973, p. 4-A.

27_/ El Mundo, March 6, 1973, p. 12-B.

an alternative to the Federal programs that were frozen by Nixon, were probably formulated without the benefit of a complete assessment of the impact of the moratorium and the housing problem in P.R. So far documents or studies that were consulted by the creators of Act 10 have not been found, if they ever existed.

The problems posed by Nixon's moratorium made the government of P.R. conscious of the dependency of the Island's housing delivery system on federal funding. The Secretary of the DOH understood at the time that it was impossible to continue fastened to the decisions of the federal government. The unavailability of federal funds created a crisis in the housing situation in P.R. This situation could have been seen as an opportunity for an evaluation of the local economy, and a time to look for alternatives that responded to the Island's realities. 28_/ But, that evaluation apparently never took place. Instead, what the P.R. Legislature created was a replication of the main provisions of Section 235. As we will see later, the main elements of Section 235 were taken uncritically to create Act 10, without considering the special conditions existing on the Island.

As of February 4, less than a month after Nixon's decision was announced, the foundation of the program that was later to become later Act 10 was already laid down. As was mentioned before, it was a plan that would put millions of dollars to the disposition of families with monthly incomes that ranged from

28_/ El Mundo, February 23, 1973, front page.

\$250 and \$700 from private banks in P.R. to the construction of housing of "social interest", a characteristic of Section 235.

In the next chapter a discussion will follow on the legislative history of Act 10, and how the program evolved.

Chapter III: Legislative history and evolution of Act 10

Legislative History

It was not until May 22, 1973, two and a half months after the banks that comprise the Savings and Loans Association League of P.R. publicly offered their collaboration with the plan, that a bill was presented by the Senate's Commission of Housing and Urban Development. Senate Bill No. 572 was presented "[T]o establish a state subsidy plan at market mortgage interest through the DOH or any of its ascribed organizations to make possible that moderate income families could acquire or rent newly constructed housing units at an annual interest cost of no more than 1 %." 29_/

What research was developed by the Commission, if any, or what documents were submitted to the Commission by the DOH or special interest groups in the housing sector that served as a basis for the creation of S.B. No. 572 are still unanswered questions. No documents produced before 1976 were located in the Commission's files. They were either destroyed ,misplaced, or never existed. However, the evidence at hand tends to indicate that the plan was produced by a task force comprised of officials from the DOH, URHC, and private bank representatives. The evidence tends to indicate that the plan was created after a meeting held on February 8 at the DOH between those individuals, and later channeled through the Commission for the Senate's consideration. It is still unknown whether this task force

29_ / Actas del Senado, Septima Asamblea Legislativa, Primera Sesión Extraordinaria.

produced any evaluation on Section 235 performance and problems in the U.S. and P.R. A one page joint report on Senate Bill # 572 submitted to the Senate by the Commission of Housing and Urban Development and the Commission on Public Finances tends to indicate that no such evaluation was done by either the task force or the Commission on Housing and Urban Development.

After summarizing the purpose of the bill, the Commission explained its two main objectives:

1. Provide low cost housing to 13,500 families that ... "are presently in a very special situation; because of their incomes [these families] do not qualify for public housing and cannot acquire a house in the private market." 30_ /

2. Inject 247 million dollars into the housing construction industry, to put it in motion.

" The freezing of federal subsidy funds for housing ordered by President Nixon, has had the effect that the private enterprise and the public sector has not been able to continue with their housing construction projects"... 31_ /

On June 9, 1973, S.B. 572 was finally approved by the Senate, and later by the House of Representatives. It was then sent to the Governor for final approval. The Governor signed it on July 5, 1973. The unamended Act 10 authorized the Secretary of Housing to incur a debt of \$9,220,000 in order to initiate a program to provide housing to 13,500 moderate income families.

30_ / Informe Comisiones de Hacienda y de Desarrollo Urbano y Vivienda sobre el P. del S. 572, 24 de mayo de 1973, San Juan, P.R., p. 1.

31_ / Ibid.

The program was sold to the public by the Secretary of Housing, Jose E. Arraras, "as one of the more ambitious programs in the low cost housing construction history, and as a decisive step towards the fulfilment of the government programmatic offering of providing each family an opportunity to own a house." 32_/ He stated some of the advantages of the program as:

1. It avoided the cost of periodic investigations.
2. It did not interfere with the privacy of the family.
3. It avoided any family effort to conceal their income in order to continue receiving the subsidy, and...
4. It avoided family resentments towards the government every time the latter investigated, and the investigations bore a subsidy reduction. 33_/

Except for two important differences, Act 10 (refer to Appendix A) followed basically the same policy concept and structure of Section 235 of the Federal Housing Act of 1968. It is like Section 235 in that:

1. It is a homeownership program for moderate income families.
2. The government develops its own housing projects or contracts to pay part of the homebuyer's mortgage payments. The government subsidy reduces the homebuyer's payment to that which he/she would owe if his/her purchase had been financed

32_/ El Mundo, July 6, 1973, front page.

33_/ Ibid.

with a mortgage bearing an interest rate of 1 % (this was later amended to take into account construction costs in high costs areas).

Two important aspects in which Act 10 did not follow Section 235 are the following:

1. Act 10 subsidy mechanism is reduced automatically, every two years, without taking into consideration changes in family income (see Appendix A, Section 6). The regulations of Section 235 allowed for subsidy redeterminations, as requested by the family, whenever their economic situation changed adversely by causes beyond their control. These optional recertifications were mandatory for the mortgagor at the mortgagee's request.

2. In the case of Section 235, the Federal government did not assume the developer role, while under the Act 10 program, the government contracts for construction of their own projects, and arranges the interim and permanent financing of them. In Section 235, the developer role was, and is still, played by the private sector.

Amendments to Act 10

Act 10 has been amended seven (7) times. The last amendment was approved by the Legislature in June, 1980. Two of the amendments extended the limit of the funds that could be committed for the subsidy plan, and the others amended and/or added sections to Act 10. A summary of the amendments will follow together with comments on the socio-economic and political context in which they were made.

1. Act #4 of October 26, 1973.

This Act amended Sections 2 and 3 of Act 10 as follows:

Section 2 - This amendment added to the original section that any public or private institution, including the "Administracion de Fomento Cooperativo", (an agency created by the government of Puerto Rico for the fomentation of cooperativism on the Island), can construct housing under the conditions that Act 10 and its regulations establish.

Those housing units can be developed using any financing method available in the market or using the low cost housing program of the URHC.

Section 3 - This amendment eliminated the requirement that in order to be eligible for a subsidy, the price of a housing unit cannot exceed \$25,000 and substituted it with the following:

"Housing units located in a project in which the average price per unit is more than \$25,000 will not be subsidized." 34_ /

This amendment increased the price of the housing units to be subsidized under the program. It established that in order for a family to benefit from a subsidy when they buy a house with a price over \$20,000 they will pay the mortgage monthly payment at an interest rate of not less than 3%.

In the unamended Act 10, the developer role was to be played by the DOH. It was not until the approval of this Act (approximately three and a half months after it was first presented) that the private sector was included as a developer.

34_ / Leyes de Puerto Rico, Ley Num. 4, 26 de octubre de 1973, p. 877.

Why the private sector and the Administration for Cooperative Promotion were not included as developers in the original Act is still unknown. However, a plausible explanation could be that because of the urgency of the government to generate a response to the housing crisis and the moratorium, the Bill was presented to the Senate at a time when the idea was not mature yet. This is partially reflected in the amendment to section 3.

The substitution of the price limit per housing unit with an average price made it possible to sell housing units of one to two bedrooms at prices that could fluctuate between \$18,000 and \$22,000, and housing units of three to four bedrooms for more than \$25,000 within a project, given that the average price did not exceed \$25,000. The fact that the original Act did not take into consideration the fact that within a housing project different types of housing units are offered to different family groups implies a lack of attention, time, and/or a lack of expertise at the right moment on the part of the legislators and the task force.

The Senate and the House of Representatives considered and approved a bill that was still in the process of definition. This reflected the urgency of the new administration to provide a quick response to a desperate situation, the likelihood of more land and housing invasions.

2. Act 244, July 23, 1974.

This Act amended Act 10 by adding a new section--section 10A--which authorized the Secretary of Housing to incur debt for an additional quantity of \$2,500.00 in order to provide housing to 16,500 moderate income families (3,000 more than

originally planned). In addition, this new section established a maximum price of \$28,500 for housing developed in high cost land and highrise buildings.

As a justification to broaden the program, it was stated in Act 244 that the state subsidy program had been extremely successful. "Proof of this is the fact that... about 7,000 housing units are in the process of being constructed that will be acquired by an equal number of moderate income families. Given the success... it is highly recommended to broaden the program." 35_/

And the reason given for establishing a higher price limit was,

"The progressive increases that construction and land costs have experienced, especially in more developed zones." 36_/

This problem of increasing construction and land costs and the need to amend Act 10 price limits forced the government to create a Board to be in charge of establishing the maximum average price of the housing units to be subsidized.

An evaluation of the criteria used by the law-makers to justify the expansion of the program shows what seems to have been a consistent problem since the creation of Act 10--their concern with the impact of the program on the housing construction industry and not with the impact of the program on the consumers. They did not know what the impact of the program on the consumers would be since the program was still

35_/ Leyes de Puerto Rico, Ley Num. 244, 23 de julio de 1974, pag. 257.

36_/ Ibid.

in its initial year, yet they were already expanding it by 3,000 additional housing units. The impact of the program on the consumers had yet to be fully assessed. In fact, the impact continues to be ongoing today. Clearly, the only ones whose benefits could have been assessed were those of the housing construction industry.

3. Act 6, November 14, 1974.

This Act further amended section 1 and added section 10(B).

Section 1: Expanded the definition for "new construction" as any constructed house that has not been occupied, that is being constructed, and/or that will be constructed for the purpose of selling it.

Section 10(B) Act 6 authorized the Secretary of Housing to incur a debt of up to \$12,200,000 for the program.

In the Exposition of Motives of this Act, it was stated that the housing construction industry in both P.R. and the U.S. was in a critical situation, but that in P.R. this industry has not suffered a total collapse because of generated activity in this sector.

"[T]he housing construction industry in Puerto Rico is one of the most important sectors of our economy, proof of this is that it represents 17% of the island's economic production. "One of the factors that had more adversely affected the purchase of housing has been the high cost of mortgage interests... [T]he interest subsidy provided under Act 10, as amended is... the mechanism of greater help to moderate income families." 37_/_

The amendment to Section 1 excluded the subsidy to houses

37_/_ Leyes de Puerto Rico, Ley Num. 6, 14 de noviembre de 1974, p. 790.

built for the purpose of renting, even though it expanded the definition for "new construction." The expansion of the definition of "new construction" included any constructed house that had not been occupied, and excluded houses for rent.

It has been said by both the government and the private sector that the preference of the people of P.R. is homeownership over renting. More specifically, in a document released by the DOH in January 1982, it was stated that Puerto Rican families prefer ownership of single family detached homes. They consider rental housing a last resort. 38_/ No explanation is given in the Exposition of Motives of Act 6 to justify the targeting of the program to the selling market in 1974. Obviously, the cooperative movement in P.R.--one of the users of the subsidy to develop cooperatively owned housing projects--was the more affected by this decision than were were consumers.

A look at the context in which this amendment was made will provide us with a clearer understanding as to why Act 10 was expanded and targeted to the housing selling market.

A study made by a private consulting firm for the Home Builders Association of P.R. gives valuable information on what was going on in the Island's economy and housing construction industry at that time (July, 1982). The oil crisis of 1973 and the world wide recession or stagflation which followed it had a heavy impact on the Island's economic processes.

38_/ Department of Housing, Evolution of the Department of Housing of Puerto Rico, Vivienda "82", Hato Rey, P.R., January, 1982, p. III.

"The severe contraction of the U.S. economy, after 1970, had dire effects on the Island's economy. In 1974, gross national product [in the United States] declined by 1.4 percent and by 1.3 percent in 1975; unemployment rose to 8.5 percent that same year (its highest level since 1941), while, at the same time, consumers prices rose by 9.1 percent that year along with increases in production costs due to both higher oil prices and the general inflationary pressures throughout the mainland. These factors severely affected Puerto Rico's economy bringing a sharp and protracted recession on the island.

"In 1975 the Island's real gross product declined by 2.0; the rate of unemployment rose from 11.8 percent in 1973 to 15.4 percent in 1975... from 1974 to 1976, the manufacturing sector lost 14,000 employments, while the economy as a whole lost 57,000. However, inflation kept growing at two digit levels .

"Gross fixed domestic investment (in constant 1954 dollars) began a steady process of decline in 1973 which caused its level to drop from \$974.8 million to \$593.9 million in 1977, a 39.1 percent contraction in only five years...

"Several factors worked jointly to transmit the recessionary environment to the Puerto Rican construction industry... The United States Policy of fighting stagflation with tight monetary policy and higher short-term interest rates led to higher mortgage interest rates. The upsurge of construction costs, closely associated with increasing cement prices due to the oil cost-push, translated into higher housing prices"... 39_/

This, together with the prevailing levels of unemployment, general income uncertainty, lower real family incomes, and the inadequacy of Federal housing programs given the higher housing prices led to a decline in the effective demand for housing.

"In particular, the recession adversely affected condominium sales at high and low price levels and, in consequence, a large inventory of unsold apartment units began to accumulate... Thus, the overbuilding of the 1972-74 period, when almost 80,000 new units were constructed, was severely punished by the economic slump of the 1974-77 period, meaning serious trouble to builders, banks, potential homeowners and the economy as a whole." 40_/

The accumulation of housing units explains why the definition of "new construction" was expanded, the limits of

39_/ Corplan, Inc., Regional Demand for Housing: Puerto Rico 1986 , San Juan, P.R., July 1982, pp. 28-30.

40_/ Ibid, pp. 30, 31.

the subsidy program increased to \$12,200,000, and the subsidy program narrowed only to houses that were to be sold. Act 10's goal to support the housing construction industry was strengthened with this amendment.

From that time on (November, 1974), the polarization between the two goals that gave birth to Act 10 increased at a faster pace. Act 10 entered a second stage in its evolution with this amendment, consolidating its application as a support mechanism for the housing construction industry on the Island.

4. Act 69, June 22, 1975.

This Act again amended Section 1 of Act 10, as previously amended by Act 6, that excluded the possibility of providing subsidy to rental housing. It eliminated from Section 1 the phrase .."for the purpose of selling it", thus opening the program to rental housing.

5. Act 11, June 20, 1978.

This Act amended Section 3 and added a new section to the original Act 10. The reasons behind these changes were explained in the Exposition of Motives of the Act.

"The maximum prices... originally established by the legislature... have been the subject of successive amendments as a result of the construction and land costs increases experienced in Puerto Rico. It is anticipated that this increase in costs will prevail... in the face of the rapid changes in housing prices it is considered to be convenient the creation... of a Board composed by the Secretary of Housing,... the Secretary of the Treasury, The Director of the Budget Bureau, the President of the [Housing Bank] and the President of the Planning Board, that will be in charge of setting... the maximum average price per housing unit... 41_/"

The amended Section 3 reads as follows:

41_ / Leyes de Puerto Rico, Ley Num. 11, 20 de junio de 1978, pp. 411-412.

"Housing units located in a project in which the average price per unit exceeds the one established by [the Board] will not receive the subsidy authorized here." 42_/

The new section 3(A) created the Board and authorized it to set the maximum average price per unit whenever the market conditions required it. The Board was in charge of setting the maximum average price per housing unit developed in low density zones, and a maximum average price per housing unit developed in high cost land and/or construction, and in buildings clasified as multifamily. 43_/

6. Act 144, June 14, 1980.

This Act conferred the Secretary of Housing the power to extend the subsidy to those moderate income families that acquired an Act 10 housing unit that was repossessed by the Urban Renewal and Housing Corporation or by the Housing Bank (agencies of the DOH), as a consequence of the proprietor's failure to perform their mortgage contract, or when they give up their house because they are not able to perform their obligations, or other reasons. 44_/

As of August 31, 1981 the effects of the program on the consumer side were beginning to be felt. Out of 10,926 housing units originated by the URHC and the Housing Bank that were sold, 731 had been repossessed (or 6.7%) at that time. 45_/

42_/ Ibid, p. 412.

43_/ Ibid, p. 413.

44_/ Leyes de Puerto Rico Anotadas , Capitulo 21, Plan de Subsidio Estatal al Interes del Mercado de Hipotecas, Seccion 660 c., p. 246.

45_/ Letter from the Secretary of Housing Jorge A. Pierluisi to Senator Jesus Santa Aponte, Appendix 3, September 23, 1981.

And as of January 13, 1982, 1,796 mortgages subsidized by Act 10, as amended, were referred to the lawyers of the DOH for the initiation of foreclosure proceedings. 46_/

Given the growing gap between housing costs and family incomes in P.R., 47_/ the DOH had only two alternatives to get rid of those repossessed housing units: resell them under Act 10 subsidy (using the authority conferred by Act 144), or resell them at a lower price without subsidy. As we will see in Chapter IV, this last alternative has been implemented by the DOH in Las Antillas and other government promoted housing projects. The reason for the DOH not applying Act 144 in Las Antillas and other housing projects could have been that the high interests rates and inflation levels created by the impact of the recession of 1981-83, made that alternative unworkable for them.

So far, all of the evidence on the history and evolution of Act 10 tends to indicate that the program was poorly designed. Instead of being an "innovative" response on the part of the Government of P.R., it uncritically followed the policy concept, and structure of Section 235 of the Federal Housing Act of 1968. After analyzing its history and evolution, one has to conclude that not much policy analysis was done previous to the design of the program.

We have seen in the last section that the subsequent

46_/ Letter from the President of the Housing Bank, Francisco J. Fantauzzi, to Senator Jesus Santa Aponte, January 26, 1982, p. 3.

47_/ Management Aid Center, El Estado de la Industria de la Construcción en Puerto Rico, 1980, 3 junio de 1980, Santurce, P.R., pp. 15, 74.

amendments made to Act 10 strengthened its application as an anti-cyclical mechanism for an industry that, unfortunately, is very cyclical. An analysis of the subsidy commitments made by the DOH up to 1977 shows the success achieved under Act 10 in increasing the private sector role in the provision of housing in P.R. (Refer to Table 2).

Looking at Table 2, we can see that the shift towards an increased participation of the private sector in the program was not a gradual process but a rapid shift: from 3.4 % housing units

TABLE 2: Act 10 subsidy commitments as of December 30, 1976

Fiscal Year	# Housing Units	% Public	% Coop.	% Private
1970	52	100	-	-
1971	-	-	-	-
1972	909	100	-	-
1973	1,823	100	-	-
1974	9,675	87.5	9	3.4
1975	2,385	30	-	70
1976	1,043	7	-	93
1977	7,657	4	4	92
TOTAL	23,544	52 %	5 %	43 %

Source: Department of Housing: Housing Projects to be Subsidized by Act 10 of July 5, 1973, as Amended, State Housing Program, December 30, 1976.

developed by the private sector in 1974, to 70 % in 1975.

Even though the construction of new housing plays an important role on other sectors of the Puerto Rican economy, the

amendments did not take into consideration the impact of the program on the consumers. The impact of the program on a government financed housing project will be assessed in the next chapter.

Chapter IV. The origin of the problems: The case of Las Antillas Housing Project

Officials from the DOH have put forward the following explanations regarding the problems in Act 10 in press conferences, newspapers, public and private forums:

1. The origin of the problems of homeowners is to be found not in the subsidy mechanism, but in the quality of the qualification process implemented by the DOH.

2. The existence of a high default rate in government financed housing projects indicates a generalized pattern of behavior that is based on the irresponsibility and lack of consciousness of the residents.

It is my contention that there are alternative explanations as to why the government financed housing units have such a high default rate (more than 50 %) other than those given by the DOH.

In Chapters II and III, the evolution and history of Act 10 were discussed in order to assess the objectives that guided its design. Also mentioned was the impact of Puerto Rico's excessive dependence on U.S. Housing policies, concepts, and programs. I concluded that the program created by Act 10 was based on incorrect assumptions about the Island's economy. I further concluded that Act 10, instead of being an "innovative" response on the part of the government of P.R., uncritically followed both the policy concept, and structure of Section 235 of the Federal Housing Act of 1968. More specifically, it was the belief of this researcher that not much analysis was done previously to the design of the program; it can hardly be said that it

went through a design process at all.

Other explanations that have not been mentioned by officials of the DOH could explain why government financed Act 10 housing projects have such high default rates. Among them we have the following:

A) It is not lack of interest in keeping their homes or "irresponsibility" that has made it difficult for residents to keep their homes, but the combination of the fixed nature of the subsidy mechanism and the impact of employment instability on these families.

B) Lack of effective responses from the DOH and mechanisms to deal efficiently with the problems of defaults and construction defects could also be a factor in the high default rates.

The socio-economic context of the problems of Las Antillas

The community of Las Antillas (or VBC-156) consist of 129 single detached housing units. The project was constructed by a private builder contracted by the Urban Renewal and Housing Corporation (URHC) between February 1974 and April 1975. The project was sold by the URHC to moderate income families through its Home Ownership Program at \$ 22,730 per house. As established by the Act, eligible families were those that showed that they were able to pay their mortgages with 20 % of their net monthly incomes (at the time of their evaluation by the DOH) with a monthly payment at a 1 % interest rate. If 20 % of the family's net monthly income could permit them to pay an amount above the monthly mortgage payment at a 1 % interest rate, the family was

obliged to pay that amount, but that amount could not exceed the corresponding monthly payment without subsidy.

It was in Las Antillas that a social movement emerged for the amendment or derogation of Act 10. This was in part due to the fact that Las Antillas was one of the first housing projects to be developed by the government with the subsidy provided by Act 10. Therefore, the impact of the automatic reduction of the subsidy every two years was felt by the residents at an early date. Above all, this was related to the socio-economic context in which the project was located--the municipio of Salinas and the south of the Island, more specifically the municipios located at the east of the municipio of Ponce, the second largest SMSA in P.R. It is in this area that most of the people of Las Antillas are employed.

In order to understand the socio-economic characteristics of this region and how they have evolved from 1970 to 1980, it is necessary to discuss the economic development strategies implemented by the government of Puerto Rico since the 1940's, and the impact of those strategies on the economic structure of these municipios.

During the first three decades of this century, Puerto Rican Society was predominantly rural. In 1920, agriculture employed 60 % of the Island's labor force. 48_/ The cultivation and processing of sugar cane was the most important economic activity on the Island. By 1936, the sugar cane farms --owned

48_/ Campos, Ricardo, et al., "Industrializacion y migracion: Algunos efectos sobre la clase obrera puertorriquena", (undated), p.15.

and controlled by U.S. corporations-- represented 65% of the best agricultural land on the Island. Most of this land was located in the coastal valleys.

With the Great Depression of 1929, coffee and tobacco production experienced a decline resulting in many workers losing their jobs. Even though the sugar cane industry maintained high rates of return, it was unable to generate enough new jobs on the Island to compensate the workers who had lost their jobs in other industries.

In 1940, P.R. was still eminently a rural society. The agriculture sector employed 40% of its labor force. But it was a rural society in crisis. The deterioration of the cultivation of tobacco, the collapse of the cultivation of coffee, and the stagnation of the sugar cane industry marked the beginning of the decline of the agriculture sector as the most important sector of the economy.

During the 1940s, the crisis of the agriculture sector and the high level of unemployment caused by the depression of 1929, moved the government of P.R. (under the control of the Popular Democratic Party --PDP) 49_/, towards the implementation of a two fold development strategy: an agrarian reform along with the industrialization of the Island directed and financed by the State. The agrarian reform pursued the goal of retaining for Puerto Rico part of the surplus capital produced on the Island which in the past had ended up in the hands of U.S. investors.

49_/ A populist alliance of diverse classes and social sectors opposed to the enclave system with the central goal of using the state to promote industrial development accompanied with measures of social justice.

This capital was to be used to finance the development of new industries. The objective was to promote and support the creation of industries with capital of the residents of P.R. and to avoid the problems of big scale absentee capital. 50_/

Several factors led to a halt of that reformist project -- production problems in some industries promoted by the government of P.R., a reduced local market for their products, resistance from U.S. corporations in control of sugar cane production, pressures from Washington in support of these interests, and the interest of the postwar U.S. to concentrate in both industrial investment and the expansion of the internal markets of dependent countries.

In 1947, the populist alliance represented by the PDP began to break into pieces. The U.S. capitalists were looking for new investment areas and the PDP began to coalesce with U.S. capitalists in order to push forward the economy given what they considered to be the "failure" of the reformist project. A "new" strategy was begun based on the importation of U.S. capital. The objective was to promote an accelerated industrial development for which it was necessary to invest a large amount of capital. For this purpose, a strategy was designed and implemented consisting of tax incentives, subsidies for industrial locations and labor force training, an ample supply of cheap labor force with low levels of unionization, and a commerce free of taxes and/or customs tariffs.

50_/ Pantojas Garcia, Emilio, "Estrategias de Desarrollo y Contradicciones Ideologicas en Puerto Rico: 1940 - 1978", Revista de Ciencias Sociales, Marzo - Junio 1979, Num.1-2, U.P.R., Centro de Investigaciones Sociales, p. 92.

This program was successful in attracting investments in manufacturing. Between 1948 and 1963, a total of 832 factories were established on the Island under its auspices. 51_/ During the same period, gross national product at constant prices (1954) increased from \$732.3 million to \$1,809.9 million, and net total income from \$609.6 million at constant prices to \$1,647.7 million 52_/. This strategy stimulated accelerated development in the manufacturing, construction and service sectors.

The more important element of this strategy was its impact on the social structure of the country. In the manufacturing sector, light, labor intensive industries predominated. In particular, the strategy generated the expansion or appearance of:

- A mass of industrial urban workers.
- A group of workers in the government and services sectors.
- A sector of administrators and technicians linked to the private sector, principally foreign.
- A sector of local businessmen linked to commerce, real estate, and finance sectors.
- A mass of displaced workers from the agriculture sector, not incorporated to production sectors.

In spite of the impressive figures of economic growth, this strategy confronted serious structural problems that were not resolved. To the extent that the agrarian reform was never completed because U.S. corporations controlled the best

51_/ Ibid. p.102.

52_/ Ibid.

agricultural lands, the crisis of the agricultural sector continued. This had two negative effects on industrial development. On one hand, industrialization was based almost exclusively on foreign investment (U.S.), not on the savings of the agricultural sector. And ,on the other hand, the crisis in that sector generated a mass exodus of people to urban areas that could not be incorporated into the productive labor force, even though the industrial sector was predominantly light and was labor intensive. This industrialization strategy, therefore, did not solve the problems of unemployment and poverty. 53_/

The increase of the unemployed and the so-called "marginal sectors" did not reach higher proportions, however, because of a massive migratory movement of Puerto Ricans to the U.S. Between 1947 and 1962, 558,000 persons migrated to the U.S. And in P.R. between 1950 and 1970 , unemployment stayed between 10 and 13 %. That is, unemployment stayed relatively high but stable. 54_/

At the beginning of the 1960's, in spite of all the efforts made by the government to guarantee the necessary conditions for U.S. investment on the Island, those labor intensive industries began to abandon the Island in search of new cheap labor markets. At that time, the cost of the Puerto Rican labor force had increased substantially as a consequence of the Federal Government's policy to push up salaries in order to put them at a level nearer to the minimum salary of employees in the U.S.

53_/ Ibid. pp.103-104.

54_/ Ibid. p.108.

With this, the exodus of light manufacturing industries began and the search for a new strategy to attract foreign capital and to avoid an investment crisis on the Island was initiated by the government.

A change in the development strategy to solve the crisis posed by the departure of the light manufacturing industry signified the establishment of big financial capital as the dominant element in the economy of Puerto Rico. It also re-oriented the target of investments away from labor intensive industries and towards heavy, capital intensive industries and financial activities.

Between 1961 and 1978, (with the exception of 1974 and 1975 when direct external investment grew by only 6.6 and 9.8 % respectively) direct external investment maintained a growth rate from 14 % to 25 %. 55_/ From 1960 to 1978, direct external investments increased from \$617.7 million to \$10,794.9 million. That is, a 1,507 % rate of growth. 56_/

In 1967, foreign industries, which constituted only 36% of all industrial establishments on the Island, provided 70 % of industrial employment, 70 % of all salaries, and produced 70% of the added value by the manufacturing sector of the Island. 57_/

Foreign (U.S.) investments were concentrated in petroleum refining, processing petroleum derivates, petrochemical products, pharmaceutical, electric and electronical products,

55_/ Ibid., p. 105

56_/ P.R. Planning Board, 1979. This source did not indicate if these figures are in constant or current prices.

57_/ Pantojas Garcia, Emilio, p.106.

and, to a lesser extent, in textiles and food.

An ongoing problem with these industries has been their incapacity to generate enough jobs to absorb the available labor force on the Island. Between 1965 and 1975, these industries invested about \$1,300 million and had only created 6,000 jobs. 58_/ That is, \$216 thousand per worker.

This development strategy, adopted in 1963, has deepened the following processes and contradictions on the Island:

1. The accentuation of the enclave nature of the economy, where the multinational corporations that control the Island's production are integrated vertically, disassociating themselves from the interests and necessities of the local economy.

2. The worsening of the capital accumulation crisis of the agricultural sector and the competitive edge of light industry-- which has made it impossible to re-absorb the labor force displaced by these sectors -- and the displacement of small producers.

As was discussed in Chapter III, the severe contraction of the U.S. economy after 1970 had dire effects on the Island's economy. Unemployment rose from 10.7% in 1970 to 11.8 in 1973 to 15.4 percent in 1975 and then to 20.0 percent in 1977, the highest level in many decades. Both the recession and inflation that hit the Island from 1974-1976 meant a reduction of real salaries of the working class, harming their economic situation. This situation also lead to the reduction of the number of employed workers in all but service and public administration

58_/ Ibid., p. 109

sectors (See Appendix B). Taking 1967 as the base year (equal to 100) the consumers price index reached 107.6 in 1970: 126.6 in 1973 and 166.2 in 1975; a 49 % increase from 1970 to 1975.

(Refer to Table 3).

TABLE 3. Prices and salaries in Puerto Rico 1970 - 1975 (1967 =100)

	1970	1971	1972	1973	1974	1975 +
Total employment in Manufacturing	136737	138126	150200	152400	142800	131000
Production workers *	114258	114714	125000	126700	116500	106300
Average nominal salary per hour	1.78	1.91	2.06	2.17	2.14	2.58
Average real salary per hour	1.61	1.65	1.73	1.58	1.50	1.55
Consumer Price Index for working class families	111.9	116.7	119.3	137.5	163.1	166.2
Dollar purchasing power	.89	.85	.83	.72	.61	.60

+ = August

* = Excluding technicians, supervisors and managers.

Sources: Employment, hours and salaries in the Manufacturing Industry of Puerto Rico: Special Report, August 1975. Annual Reports of the Labor Department: 1972; 1973; 1974. Consumer Price Index. May 1941 - August 1975, Statistics Bureau, Department of Labor.

In the municipios east of Ponce, the impact of both the economic development strategy implemented by the Commonwealth and of the recession of 1974-76 was great. From 1970 to 1980, the municipios of Guayama, Salinas, Santa Isabel, Juana Diaz, and Ponce experienced together an unemployment growth rate of 435%. (Refer to Table 4, p.52).

Guayama, the largest municipio east of Ponce, experienced a

TABLE 4: Civilian Labor Force and Employment Growth Comparison by Municipio, the Region, and Puerto Rico:1970-1980

	1970		1980		% Rate of Growth
	n	%	n	%	
Guayama					
- Civilian L.F.	5,894	100	9,843	100	67
-Employed	5,667	96.2	7,250	73.6	28
-Unemployed	227	3.8	2,593	26.3	1,042.3
Salinas					
- Civilian L.F.	3,477	100	5,981	100	72
-Employed	3,267	94	4,896	81.9	50
-Unemployed	210	6	1,085	18.1	416.7
Santa Isabel					
- Civilian L.F.	2,788	100	4,744	100	70.2
-Employed	2,639	94.7	3,895	82.1	47.6
-Unemployed	149	5.3	849	17.9	470
Juana Diaz					
- Civilian L.F.	5,316	100	10,141	100	90.8
-Employed	5,104	96	8,247	81.3	61.6
-Unemployed	212	4	1,894	18.7	793.4
Ponce					
- Civilian L.F.	38,826	100	49,091	100	26.4
-Employed	36,838	94.9	40,619	82.7	10.3
-Unemployed	1,988	5.1	8,472	17.3	326.2
The Region					
- Civilian L.F.	56,301	100	79,800	100	41.7
-Employed	53,515	95	64,907	81.3	21.3
-Unemployed	2,786	5	14,893	18.7	434.6
Puerto Rico					
- Civilian L.F.	672,415	100	865,719	100	28.7
-Employed	634,961	94.4	733,922	84.8	15.6
-Unemployed	37,454	5.6	131,797	15.2	251.9

Source: U.S. Bureau of the Census: 1970-1980.

rate of growth in its unemployed labor force of 1,042.3, the biggest increase in the region--from 3.8 % unemployment in 1970 to 26.3 % in 1980.

In this region, the industries most affected by the recession were construction and manufacturing, specifically their non-durable sector (refer to Appendix B). The municipios of Guayama and Salinas experienced the biggest reductions in employment in the manufacturing sector throughout the decade.

As we will discuss later, the reduction of job opportunities in Guayama because of plant closings as well as the establishment of capital intensive industries was to have a negative impact in Las Antillas.

What was the impact of that development strategy and the recessions of 1974-76 and 1981-83 in Las Antillas ? The following studies the history of Las Antillas, some of its socio-economic characteristics, and how they have evolved from 1974 to the early 80's.

The evolution of the socio-economic profile of Las Antillas

As of December 1974 as reflected in a sample of 40 original households surveyed on April 1985, 71 % of the surveyed labor force was employed in non-durable manufacturing and services industries, the latter being the more represented industry employing 40 % of the surveyed labor force, followed by manufacturing with 35 %. (Refer to Table 5, p. 54).

A comparison between industry of employed persons in 1974 and 1985 in Las Antillas shows that manufacturing experienced a rate of growth of - 41 %, while service industry experienced a rate of growth of 32 %. However, this has to be taken with a grain of salt. Given that, (as we will see later on), the original population of Las Antillas has changed since 1974--as of April 1985 only 61 % of the original owners still reside in the community. This sample could not be a fair representation of industry of employed persons in 1974. More specifically: information provided by residents of the community indicates

TABLE 5 : Industry of employed persons in a sample of 40 households + Las Antillas, Salinas: December 1974 - April 1985

Industry	1974		1985	
	n	%	n	%
- Agric., Forestry, Fishing	--	--	--	--
- Mining	--	--	--	--
- Construction	2	4	--	--
- Manufacturing	17	35	10	22
- Durable	(2)	(12)	(2)	(20)
- Nondurable	(15)	(88)	(6)	(60)
- Not specified			(2)	(20)
- Trans., Comm., & other Public Utilities	1	2	2	4
- Wholesale and Retail	4	8	3	7
- Finance , Insurance and Real Estate	1	2	1	2
- Services	19	40	25	56
- Public Administration	4	8	4	9
	n = 48	100	n = 45	100

+ First, original owners.

Source: Socio-Economic Study of Las Antillas No. 2, April 1985.

that the closing of a textiles factory (Fibers, Inc.) located in Guayama in 1977 affected about 40 % of the community's labor force--those that were employed in companies contracted by Fibers as well as production line workers. From the information collected through the survey of 1985, 13 % of the surveyed labor force worked for Fibers in 1974. Therefore, it is highly probable that a big percentage of those who left Las Antillas were employed in the manufacturing industry.

Of those who worked for Fibers in 1974, some were able to find jobs in the Aguirre Sugar Mill located in Salinas. A problem with this industry, though, is that it is seasonal. Others were able to find jobs in services or became self-employed.

It is clear that the impact of employment instability on the region has been negative as reflected in a survey of the community in 1981. Out of 66 households surveyed, 73 % had to allocate between 21 to 69 % of their incomes to pay their monthly mortgage payments (refer to Table 6).

TABLE 6: Monthly mortgage payment as percentage of family gross monthly income +, Las Antillas, Salinas: May 1982

Percentage level	n	%
< 20	18	27.3
21 - 40	37	56.1
41 - 60	8	12.1
61 >	3	4.5
TOTAL	66	100

Source: Socio-Economic Study, Las Antillas, May 1982

+ The questionnaire did not ask to give net income. It only asked for salaries of employed persons.

Since the deductions of Act 10 apply only at the time of the qualification of the potential homeowner, the percentage of income that goes to pay the monthly mortgage payment could be even higher in the case of families that have increased in number, and lower in families that have experienced a decrease in family members since 1974. Unfortunately, no specific

information on family size and composition was collected through the survey. This could have been helpful in constructing a more precise picture of the percentage of income each family would have to allocate to pay their mortgage.

Nevertheless, as of May 1982, it is clear that the ability of 73 % of the surveyed residents to keep up with their monthly mortgage payments was different from when they became homeowners in 1974. Since 1974, they have experienced the impact of inflation and the reduction of the purchase power of their money. In addition, the percentage of their income that goes to pay the mortgage have increased too.

Clearly, this is not the same employment and income scenario which existed in 1974, when percentage of income of eligible families to be allocated to pay mortgage payments could not exceed 20 %. An important element intervening in this situation is the subsidy mechanism. As mentioned before, the subsidy mechanism assumes that family income will increase steadily allowing them to keep up with the biannual increases in monthly mortgage payments. In order to illustrate the impact of the subsidy mechanism on Las Antillas, I will use the amortization schedule of one of the residents of the community and apply it to a hypothetical family of 4 members--a married couple with two children.

First, let us assume that this family has an annual gross income of \$8,936.66 and that they are interested in buying a house in Las Antillas at a price of \$22,730. They are evaluated by technical personnel from the DOH and it is found that--after deductions have been applied--20 % of their net monthly

income (\$620.25) is equal to the mortgage payment for the first two years at 8.5 % interest with Act 10 subsidy, or \$124.05 (refer to Table 7). In order to maintain that same percentage of their monthly income to be allocated towards the monthly payment (20 %), their income will have to increase by an average of 7.3 % every two years.

TABLE 7: Monthly mortgage payment and monthly income for an hypothetical homeowner in Las Antillas assuming income increases

Years	Monthly Income	Monthly Mortgage Payment *	Subsidy *	% of income towards mortgage
1 - 2	\$620.25	\$124.05	\$78.94	20
3 - 4	665.40	133.08	69.92	20
5 - 6	711.95	142.39	60.61	20
7 - 8	763.25	152.65	50.35	20
9 - 10	819.85	163.97	39.03	20
11 - 12	882.20	176.44	26.56	20
13 - 14	951.00	190.20	12.80	20
15 - 30	1,015.00	203.00	0	20

* = Monthly mortgage payment and amount of subsidy for a \$22,730 house in Las Antillas at an interest rate of 8.5 % in 1974.

If the income of this family stays the same throughout those years, the percentage of their income to be allocated towards the monthly payment will go from a low 20 % to a high 33 % by year 15. If we take inflation into account, the situation for this family will worsen with no increase in income, not to mention the problems that employment instability

could bring about.

An analysis of 18 families in Las Antillas which as of May 1982 were able to allocate 20 % or less of their monthly income towards housing costs, showed that in 7 out of 18 families (39 %), both the homeowner and her/his spouse were employed with an average monthly income of \$1,340.29. In the families where only one person was employed, the occupations that predominated were teachers (considered to be a stable and relatively well paid job) and workers in high tech industries (the salaries in this sector are higher than those of other industries in the region). The average monthly income of these families was \$836.00 in May 1982.

In the group of families that had to allocate between 21 % to 30 % of their monthly income towards housing costs, I found no families where both the homeowner and spouse were employed, and an unemployment rate of 17 %. Within this group, occupations were varied. There were auto mechanics, maintenance workers, nurses, taxi drivers, teachers, clerical workers, store clerks, and laborers, among others. There were also 6 families composed of divorced women with children, and 2 retired homeowners. The average monthly income of these families was \$640.00 in May 1982.

Within the group of families that had to allocate 31 % or more of their income towards housing costs, there were no families where both the homeowner and spouse were employed, and an unemployment rate of 20 %. Again, there was diversity in the occupations of employed persons: cookmaids, clerical workers, nurses, and workers in the Aguirre Sugar Mill. There

were also 7 families composed of divorced women with children in this group. The average monthly income of these families was \$364.00 in May 1982.

As was mentioned before, many families have been forced to leave the community. As of April 25, 1985, only 51 of the 66 households who answered the first socio-economic study between September 1981 and May 1982, were still living in Las Antillas. Out of 129 housing units, only 79 (or 61 % of them) were occupied by the original home owners in April 1985. (Refer to Table 8).

TABLE 8 : Tenency in Las Antillas as of April 25 ,1985

Tenency	# h.u.	% h.u.
Owner occupied	107	83
- Original owners	(79)	(74)
- New owners	(28)	(26)
Renter occupied	8	6
Invaded	2	2
Abandoned	12	9
TOTAL	129	100

Source: Socio-Economic Study of Las Antillas No. 2, April 1985.

As of April 1985, there were only four known cases of repossessed housing units in Las Antillas that were resold by the DOH. The details of these transactions are not well known, however. The resident's knowledge about the transactions is that a realtor was involved and that no subsidy was granted to the new owners by the DOH.

One can only wonder about whether this was meant to be the

objective of the program--a housing project of new homeowners only 10 years after its construction. Certainly this has been harmful, not only for those families who have left the project, but for the government as well. High default rates are making these mortgages very unattractive in the secondary market, limiting the capacity of the DOH to recover the invested money and redirect it into other programs.

How much responsibility does the DOH bear in all of this ? How effective has the DOH been in monitoring and taking timely steps to address these problems ? These are the more relevant questions that I will try to answer in the next Chapter where I will look at the demands of the residents of Las Antillas and the way the DOH has responded to them.

Chapter V: The demands of Las Antillas and the DOH responses to those demands

"We Can Not Pay, and We Can Not Move"

With this slogan, the residents of Las Antillas expressed their dilemma of both not being able to pay the increase in their monthly mortgage payments and having a lack of alternatives for decent and secure homes.

Some residents of Las Antillas stated in the last survey taken by this reaeacher that no orientation was provided by the DOH on what Act 10 was: 79 % of those surveyed answered that they were never given information on this matter.

It was not until 1977 (the year when Fibers closed their operations in Guayama) that the residents of Las Antillas began to feel the impact of the subsidy mechanism and suffer the problems of construction defects. In that year, the organized residents requested a public hearing from the House of Representatives to discuss their problems and attempt to find solutions to them. The public hearing was held in Las Antillas on November 16, 1978.

Residents of the community participated in the hearing as well as an official from the DOH. It appeared that the DOH knew about the problems of Las Antillas but did not do anything about them, according to a report on the public hearing submmitted to the House by its Commission of Housing and Urban Development on September, 1979. 59_/ The residents of Las Antillas hoped

59_/ House of Representatives, Commonwealth of P.R., Supplementary Report, September 21, 1979, 8 th Legislative Assembly, 6 th Extraordinary Assembly, p.1.

that an action on the part of the DOH would be taken afterwards, but that action never came.

Three and a half years went by without any positive response from the DOH on both the problem of construction defects and the inability of home owners to keep up with their payments. During that period of time, three actions were taken by the DOH regarding the problem of defaults:

1. The DOH refused to accept back payments unless they were large enough to make the mortgage current; an owner who was two payments behind could not recover by making two successive double payments.

2. Given this "all or nothing" policy, foreclosure proceedings were initiated against 32 out of 83 homeowners that were defaulting mortgagors as of August, 1982.

3. On June 1978, the Housing Bank and the Urban Renewal and Housing Corporation (URHC) contracted the services of a private collection agency, First Service Corporation, (a branch of Caguas Federal Savings, the second largest holder of private Act 10 mortgages--10.2 %) to manage their mortgages.

For three years and seven months, the residents of Las Antillas sent letters to the Secretary of Housing, the Housing Bank, and the Urban Renewal and Housing Corporation (URHC) requesting personal interviews. They also wrote the Governor requesting his personal intervention. Finally, the residents decided to request a public hearing from the Senate to discuss the problems and possible alternatives. On January 21, 1981, the Senate approved a resolution requesting a study from the Commission of Housing and Urban Development on the

implementation of Act 10 by the DOH and its agencies--the Housing Bank and URHC.

On August 3, 1981, the public hearing was held. The residents of Las Antillas, their lawyer, and the former Secretary of Housing, Jorge L. Pierluisi, clearly stated their positions at that public hearing regarding the problems of Act 10.

The lawyer of the community at that time, Carlos Rodriguez Rivera, made an analysis of the major shortcomings of Act 10 and gave specific recommendations to solve the problems. 60_/ In addition to those problems that have been analyzed previously such as Section 5 and Section 6 (which referred to the socio-economic evaluation of the family for the determination of the initial subsidy, and the subsidy mechanism), other problematic sections were analyzed as follows:

- Section 7: This section states that if the owner defaults on his/her monthly payments, he or she will be penalized with the elimination of the subsidy. 61_/

- Section 10: The Act does not guarantee the permanence of the social character of the low cost housing projects under this program. In this section, it is stated that a property could be sold to a family with an income that could permit the government to eliminate the subsidy totally, thereby taking that housing

60_/ Rodriguez Rivera, Carlos, Ponencia Ante la Comision de Desarrollo Urbano y Vivienda del Senado Relacionada con la Problematica de la Vivienda en Proyectos a Bajo Costo Subsidiados por La Ley 10 del 5 de Julio de 1973, San Juan, P.R., 3 Agosto de 1981.

61_/ Ibid., p.4.

unit out of the market for moderate income families, as it is defined in Section 1. 62_/

Other deficiencies discussed were:

- It does not provide a mechanism to protect the owner against mortgage claims. Specifically, Act 10 does not guarantee the right of the consumer to be heard before she or he is brought to court. Actual intervention against defaulting mortgagors is a direct one, utilizing the services of collection agencies which, in turn, contract the services of law firms to initiate foreclosures proceedings. 63_/

- Act 10 does not limit the intervention of private banks in financing housing of "social interest", which is the goal that guides government intervention in the housing sector. The non-regulation of intervention of private banks in financing housing units with Act 10 subsidy leads the government to lose control over the future of those housing units of "social interest." 64_/

A number of alternatives were suggested by the lawyer to solve these problems:

1. Derogate Act 10, if possible, and substitute it with Act 141 of June 14, 1980--a mortgage interest subsidy program for the life of the mortgage (30 years) which provides the mechanism of voluntary and mandatory recertifications of family income to adjust the subsidy according to the changes in family income. 65_/

62_/ Ibid., p.5.

63_/ Ibid., p.7.

64_/ Ibid., p. 6

65_/ Ibid., p. 8.

2. If it can not be derogated, then an amendment to the Act should include the following:

a. A mechanism of voluntary and mandatory recertifications of family income in order to adjust the subsidy mechanism to what the family is able to allocate. This would permit the reduction of the subsidy in those cases where the family income would allow it. 66_/

b. Eliminate the disposition of Section 7 of the Act which provides for the automatic elimination of the subsidy for defaulting mortgagees. In cases of justified defaults (such as forced unemployment), the monthly mortgage payments could be frozen for a determined number of months, giving the government the responsibility of paying the total amount of mortgage payments and providing the mortgagee a payment plan for future reimbursement of that amount. 67_/

Jorge L. Pierluisi, former Secretary of the DOH, responded to the alternatives proposed by the lawyer of the community with the following statement:

"I can not tell a family that I will lower to a half their monthly payment. The mortgage is committed with bonds that have to be paid. And you can not change the conditions by which those bonds were issued and how you collect the money to pay these bonds because the People of Puerto Rico can be declared in `Bond Default`. If the People of Puerto Rico are declared in `Bond Default` this would mean the total ruin of the bonds selling system and the government will be unable to finance itself. This is very dangerous. So, we have to do all we can in accordance with the `Bond Agreement`, and within this agreement and with the flexibility we have, but within the limitations, we work". 68_/

66_/ Ibid., p.9.

67_/ Ibid., p.12.

68_/ Taken from the recorded participation of Jorge L. Pierluisi during the public hearings, August 3, 1981.

As a short term "solution" to the problem of high default rates in government financed housing projects, Pierluisi presented a Mortgage Stabilization Plan which consisted of the following points:

1. A six (6) months probatory period during which the defaulting mortgagor's capacity to pay the monthly mortgage payments would be tested.

2. After the six months period, the mortgage deed would be modified.

3. The life of the mortgage would be extended as necessary to include the total amount of months owed.

The residents of Las Antillas accepted the plan on strategic grounds, but felt that it was not a long term solution to their problems. Their hope was still the derogation of Act 10, or its amending.

A bill evolved five and a half months later from the Commission of Housing and Urban Development, out of the proposal to derogate or amend Act 10 from the lawyer of Las Antillas. Senate Bill 417 of January 18, 1982 amended Act 10, incorporating into it the two suggested amendments made by the lawyer of Las Antillas. The Bill provides mortgage interest subsidy to families that are or would be beneficiaries of the provisions of Act 10, as amended, that demonstrate that have no capacity to pay their mortgage payments. The Bill establishes a subsidy for the life of the mortgage. The eligible families should have the capacity to pay at least the equivalent of 5 % annual interest rate. The Bill extends these benefits to those families that acquire from the DOH

repossessed or handed over housing units.

For three consecutive years, since 1982, the bill has been approved by both the Senate and the House, but never by former Governor Romero Barcelo.

The reasons for the Governor's veto of the amendment were never given. However, in a letter sent to the President of the Senate's Commission on Housing and Urban Development by the former Secretary of Housing, a number of reasons were spelled out for the executive branch disapproval of the amendment. Among the reasons given was the argument that the origin of the problems of government financed Act 10 home owners was to be found not in the subsidy mechanism, but in the quality of the qualification process implemented by the DOH.

"Therefore,...we do not understand that the solutions for the implementation problems of Act 10 program lie in its amendment since that action does not guarantee the reduction of foreclosures and the reduction of default rate". 69_/
69_/

As of March, 1984, the position of the DOH relied on a partial analysis of the implementative problems of Act 10. Their analysis was based on the differences in default rates between privately financed (9 %) and government financed (50 %) Act 10 housing projects. The DOH's explanation for this difference was poor screening and underwriting, which allowed households to own a house they could not afford, resulting in a high default rate. This explanation--that could partially explain the problem of high default rates--lead the DOH to leave the marketing of

69_/ Pierluisi, Jorge A., Letter sent by the Secretary of Housing to the Commission of Housing, March 7, 1984, pp.1,2.

government financed units to the private sector, considered to be more efficient in screening and underwriting.

"As a result...[the problem of] poor screening and underwriting which allowed households to own a house they could not afford, [have been reduced]." 70_/

This researcher has not found any reliable figures on differences between past and present defaults rates to support this statement.

Other reasons given by the DOH to oppose the amendment were as follows:

1. The amendment applied only to families that were financed by the DOH, thus discriminating against those families that were under the program but were financed by the private sector. By providing only these benefits to families financed by the DOH there...

"...is the danger that those defaulting mortgagors in the private sector... could adopt a different attitude towards their obligations. That is, they could begin to default adducing economic incapacity, or could put pressure [on the private banks] in order to receive equal treatment". 71_/

2. The amendment extended its benefits to those families who acquired properties handed over to or repossessed by the DOH. It authorized the reselling of those houses at the same interest rate as the original mortgage and the application of the subsidy for the rest of the life of the mortgage. This could probably be done in cases where the DOH financed

70_/ Battelle's Columbus Laboratories, Evaluation of the Mortgage Interest Subsidy Program and Related Programs of the Commonwealth of Puerto Rico, Columbus , Ohio, 1979, p.II-61.

71_/ Pierluisi, Jorge A., March 7, 1984, p. 7.

directly. However, given that an interest rate higher than the original one could not be arranged, it would be very difficult for the DOH to make liquid the value of those properties since their acquisition could not be financed through the private banks. Therefore, the DOH would have to deal with high risk mortgages, and the lack of liquidity.

The DOH opposed the proposed amendment on March 1984 for these and other reasons (like the high costs that the amendment would represent to the government of P.R.). However, no long term alternatives were provided by the DOH to solve the problems. Aside from the Mortgage Stabilization Plan, no other alternatives were provided.

So far, as we have seen, the actions taken by the DOH have not solved or even alleviated the problems of the residents of Las Antillas. The Mortgage Stabilization Plan came late. The "all or nothing" policy implemented by The DOH made mortgage degeneration in Las Antillas more irreversible than it needed to be. Out of 65 families that were surveyed in 1982, (the year when the plan was implemented in Las Antillas) 51 still reside there as of April 1985--14 families left Las Antillas between 1982 and 1985.

Even for the DOH, the program has created a big problem. It is unattractive to the lending community. Lending institutions have been unable to sell Act 10 subsidized mortgages in the secondary market. Act 10 mortgages have not been perceived as a good investment because they have been associated with extremely high default rates, in addition to some uncertainty concerning the financial capability of the

Housing Bank to back Act 10 mortgages in case of default. 72_/_

On April 19, 1985, the new Secretary of Housing, Jaime Torres Gastambide, announced a plan to derogate Act 10 and refinance all Act 10 mortgages at prevailing market interest rates. He stated that the program represents an astronomic debt for the government and suggested the use of that money for the construction of housing for moderate income families. 73_/_

72_/_ Battelle's, 1979, pp.IV-14,15.

73_/_ El Mundo, April 19, 1985, p. 49.

Chapter VI: Major conclusions

Up to this point, the thrust of the findings tend to confirm that the combination of the fixed nature of the subsidy mechanism and the impact of employment instability on these families, and the lack of effective responses from the DOH to deal with the problem of defaults, are strong explanations for the high default rate experienced in government financed housing projects. The purpose of this chapter is to present a synthesis of the research findings regarding the design, implementation, and evaluation aspects of the Act 10 mortgage interest subsidy program.

A. Design of the program

One has to conclude that Act 10 was poorly designed after evaluating the available documents and information both prior to, and following the creation of the program. The program was created as a response to the crisis posed by the moratorium on new housing commitments, and to the land invasions movement of the early 1970's. That context gave birth to the following goals:

- The provision of low cost housing units to moderate income families.
- The injection of 247 million dollars into the housing construction industry.

It appears from the analysis of the history of Act 10, that the definition of the program's goals was shaped by the need to generate an alternative that would serve both as an "exhaust valve" to deflate the land invasions movement of those

years, and at the same time, to provide a support mechanism to the housing construction sector.

It appears that the government unstated goal was to provide a short term housing alternative in order to generate vacancies in public rental housing projects, that would in turn, be granted to families with an urgent need of housing, i.e. potential land invaders. 74_/ In fact, during those days, the government acknowledge that people's confidence on the DOH's capacity to satisfy their urgent housing needs was very low.

"...[The] people have lost their faith on the URHC and are taking by the use of force what correspond to them". 75_/

One question that arises after studying the evolution of Act 10 is why the government played the developer role during the early stages of the program, and later, was handed that responsibility over to the private sector. It is probable, that, once the government understood that the goal of stopping the land invasions movement had been achieved, decided to hand over to the private sector the developer role.

This is not to say that the goal of supporting the housing construction industry was not being achieved while the government played the developer role. As of December 31, 1976, 48 % of interim financing of government promoted Act 10

74_/ The program should have generated the same filtering process on the private rental housing market.

75_/ El Mundo, January 13, 1973, front page.

housing projects was provided by the private sector. 76_/ Later, with the opening of the program to the private sector, 100 % of both the interim and permanent financing was provided by it.

As discussed before, Act 10 followed the same policy concept and structure of Section 235 , applied to a different context. As we have seen in the case of Las Antillas, the assumptions underlying the subsidy mechanism did not fit the socio-economic context of Las Antillas, and probably of P.R. Apparently the creators of Act 10 used general economic trends in the Island's economy in defining the subsidy mechanism, without considering any possible differences between geographical regions, or individuals within the moderate income category.

Once the program was opened for the participation of the private sector, the target population was subjected to differing treatment or criteria--those of the government and the private sector. The different treatment by the private sector and the government could partially explain the differences in default rates between government and privately financed housing projects, i.e. the DOH making low-moderate income families mortgageable, while the private sector skims upper income level of the target population who just barely qualify, in order to insure success. This thinking could make

76_/ Department of Housing, Housing Projects to be subsidized by Act 10 of July 5, 1973, as amended, State Housing Program, December 30, 1976.

these upper level applicants easier to qualify--they would have less credit problems, more financial resources and more stable income/jobs.

If this has, in fact, been the case, then Act 10 benefits have been accrued only by those in the upper income levels of the target population of the program. The analysis of the case of Las Antillas indicates that that has been the general trend.

B. Implementation and evaluation of the program

The high default rate experienced in government financed housing projects, and the abandonment of their houses by the original homeowners, exemplify the DOH's inability to cope with the problems associated with the implementation of this program. The DOH has been forced to transfer gradually the most important functions of the program to the private sector.

That process began with the opening of the program to the private sector. Next, the DOH placed the management of their mortgages in the hands of a private collection agency. And, later, they placed the marketing, screening, and underwriting functions in the hands of realtors.

The main argument put forward by the DOH to justify these actions is that the private sector is more efficient in carrying on these functions. This might be true, but, it cannot be used as an excuse to hide the problems inherent in Act 10, and the government responsibilities in the design and implementation of this state housing program.

From the analysis of the amendments made to Act 10, it seems that the only evaluation mechanism in place has been that of measuring the impact of the program on the housing

construction industry. As of today, it appears that the DOH never placed an evaluation mechanism to measure the impact of the program on the homeowners. This seems to be the case even under the management of the DOH mortgages by the private sector.

Certainly a more complete evaluation of the program performance on government financed housing projects is needed. An important question that needs to be researched is what explains the difference in default rates in government and privately financed housing projects. This will require a more complete assessment of the impact of the program in all government financed housing projects and, also, on those financed by the private sector. It would also require an evaluation of the screening and underwriting procedures carried out by the government and the private sector in order to know how the difference in objectives of both sectors are reflected in those procedures.

There is an urgent need to know more about the program. We need to know what changes to the program would be of more help to those families that are in a different economic position of that which they were when they enter the program. Is the derogation of the Act the best solution ? What interests should the government protect, those of the private sector, or those of homeowners who were evaluated and financed by the DOH ? What can be learned from the Act 10 program with respect to future policies regarding tenure choice for moderate income families on the Island ? It is the contention of this researcher that

until a more complete assessment of the program performance is achieved, these and other relevant questions will not be fully addressed. A more thorough analysis of the experience gained through this program by the Commonwealth, consumers, and the private sector, should lead to a discussion on whether to continue concentrating resources on homeownership programs for low-and moderate-income families in the future.

New ways and means to solve our housing problems in a more creative and realistic way should develop out of the analysis of the experience gained through the Act 10 program. Future housing policies and programs should be formulated and implemented as part of a coherent economic development strategy for P.R. No homeownership program will effectively address the housing needs of those in the lower end of the moderate income families if employment issues are not fully addressed by the Government and the private sector.

APPENDIX A

Act 10 of July 5, 1973 (Summary)

Section 1: Definitions

- "New construction" means housing units that are to be constructed after the approval of the subsidy plan.
- "Net monthly income" means one twelve(1/12) of annual income after deductions allowed in section 4 of this Act.
- "Moderate income families" means.

a. Any family composed of two or more persons with an income higher than the income required to make them eligible for public housing constructed and administered by the DOH, and that at the same time their income does not allow them to buy or rent an adequate, secure, and hygienic house built by the private sector.

b. Families that, even if they are eligible for public housing, have enough income to rent or to buy a housing unit that complies with the requirements of this Act.

The Secretary of Housing determines the maximum income of families that will be beneficiaries of this program.

Section 2

The Secretary of Housing is authorized to create a program to subsidize the market interest cost of mortgages to families of moderate income through the URHC and/or the Housing Bank in order to help these families acquire or rent housing of new construction developed under the Low Cost Housing program created by Act 82 of June 26, 1964 (which authorizes URHC to provide housing that will be sold or rented to moderate income families), as ammended.

Section 3

The subsidy is to reduce the cost of interest in the mortgage market to a minimum annual interest cost of 1% that will be paid with the 20% of the family net monthly income.

Housing units with prices higher than \$25,000 will not be subsidized. In order to be eligible for the subsidy plan, the price of the housing unit should be in the price range of \$20,000 to \$25,000. The monthly mortgage payment will be paid at an annual interest that will fluctuate between 2% and 3%, as determined by the Secretary of Housing. If the 20% of the family net income results in a higher monthly payment, the family will be obliged to pay said amount.

Section 4

Net monthly income is equal to one-twelfth (1/12) of the total annual income, after subtracting the following credits:

1. 10% of the gross annual income for payroll deductions.
2. \$300.00 for each dependent younger than 21 year that does not work.
3. \$300.00 for each family member older than 65 years.
4. \$300.00 for each physically or mentally handicapped member.
5. \$300.00 for each college student older than 21 years.

(These credits still prevail in 1985).

Section 5

To determine the initial subsidy amount, the DOH will carry on a socio-economic investigation of the families interested on the subsidy.

Section 6

The subsidy will be readjusted every two years according to

the following schedule: (the initial subsidy is equal to 100% of the interest).

Years	Government (%)	Buyer's Participation (%)
1-2	100	0
3-4	88.57	11.43
5-6	76.78	23.22
7-8	63.78	36.22
9-10	49.44	50.56
11-12	33.64	66.36
13-14	16.22	83.78
15	0	100

Section 7

To be eligible for the subsidy according to the above schedule, the corresponding monthly payments should be kept up to date.

Section 8

The Secretary of Housing is authorized to incur a debt of up to \$9,220,000 on subsidy payment during the first year (1973-74).

The Budget Bureau will assign the needed yearly amount to honor the obligations incurred by the DOH in the operation of the program.

Section 9

The Secretary of Housing will adopt any necessary regulations that are consistent with the purposes of this Act, to facilitate compliance with its sections.

Section 10

If the owner sells the housing unit to a third person in violation of the established rules, the Secretary of Housing will charge the selling party the received subsidy plus the interest at the same fixed percentage rate on the mortgage.

If the new owner wants to benefit from the subsidy, he/she should comply with the following requirements:

1. Be up to date in the monthly mortgage payments.
2. Comply with all parts of law and regulation requirements that apply to both the original buyer, as well as to the new buyer.
3.
 - a. The new owners should have a net monthly income as to be able to pay the required monthly payment in the year of sale with 20 % of their net monthly income (refer to Section 6).
 - b. If 20% of their net monthly income is higher than the corresponding payment for that year, the family will be obliged to pay that higher amount.
 - c. On the contrary, if 20 % of the net monthly income is equal to, or higher than the monthly mortgage payment at market interest rate, the subsidy will end immediately.

Percentage distribution of employment by industry: Employed persons 16 years old and over: 1970 - 1980.

Industry	Guayama		Salinas		Santa Isabel		Juana Diaz		Ponce		The Region		Puerto Rico	
	70	80	70	80	70	80	70	80	70	80	70	80	70	80
Agric., Fish, Forestry	11	5	18	13	28	13	14	11	4	2	8	5	8	4
Mining	.2	-	.1	-	-	-	.6	.5	.1	.2	.2	.2	.2	.1
Construction	14	7	12	6	10	6	18	10	13	7	14	7	12	7
Manufacturing	26	21	32	26	25	25	24	20	25	22	26	22	26	20
-Durable	(30)	(20)	(4)	(25)	(6)	(40)	(27)	(34)	(28)	(33)	(25)	(31)	(27)	(37)
-Non-durable	(70)	(81)	(96)	(75)	(94)	(60)	(73)	(66)	(72)	(67)	(75)	(69)	(73)	(63)
Trans., Comm., & other pub. utilities.	5	8	6	8	6	6	5	5	7	7	6	7	7	7
Wholesale & retail	16	15	10	12	10	12	13	13	19	20	16	17	17	18
Finance, Ins., & Real Estate	2	2	.3	1	.1	.6	.8	2	2	3	2	2	3	4
Services	20	30	17	23	16	23	19	28	24	30	22	29	32	28
Public Admin.	6	13	5	12	5	16	7	10	6	10	6	11	8	13
TOTAL	100.2	101	100.4	101	100.1	101.6	101.4	99.5	100	101.2	100.2	100.2	100.2	101.1

Source: U.S. Bureau of the Census; 1970, 1980.

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